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IREON Members discuss 1031 Exchanges

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How will the Biden Administration's position on real estate investment and 1031 exchanges impact the NY Metro market?

Q: Should I sell my income-producing properties now, or wait until the market has more time to recover from the COVID pandemic?

Whether you should sell now or wait, depends on the property type, e.g., hotel, retail, office, multifamily, or industrial. If your properties are in the hospitality or retail categories, they already have been severely impacted. Consequently, it may be prudent to wait to sell unless you face losing them to foreclosure. If the properties are in the multifamily or industrial categories, it is probably better to sell and close the transaction before the end of the year because the consequences after January 2022 of the rise in capital gains taxes. income taxes, elimination of the 1031 exchange tax deferment, and the step-up in tax basis when a person dies, will negate any possible gain in the selling price of the real estate. - Steve Kirschner COO / Lic. Broker Rep., IREON d/b/a Principals Direct Group, SKirschner@IreonNetwork.com (mailto:SKirschner@IreonNetwork.com)

Q: I sold my property, will not use a 1031 exchange, and am concerned about my tax bill, especially with the potentially increased tax rate, possibly retroactively applied. What can I do now?

There is a way to ease the pain, at least for future generations and it works like this: Use some of the gain to purchase insurance products, donate them into a Charitable Lead Annuity Trust, i.e., CLAT. The U.S. allows the taxpayer to deduct up to 30% of adjusted gross income for contributions to the trust, so the seller saves right off the bat. Only the original deposit plus government set interest must be donated. The Internal Revenue Service adjusts the interest rate threshold. Right now, gains over 1.2% accrue, where they grow, untaxed, for later distribution.

The best part of this is the CLAT family benefit is a gift tax free transfer! Tax deduction, increased charitable footprint, wealth transfer for future generations without an impact on your future gifting limits. It is a trifecta of benefits! - Jordan Toder, CEP, CLU, Preservation Capital Partners LLC, JToder@PresCapLLC.com (mailto:JToder@PresCapLLC.com)

Q: How will the Biden Administration's position on real estate investment and 1031 exchanges impact the NY Metro market?

As an attorney who represents buyers and sellers of investment real estate, including multifamily, mixed-use, office buildings, and development projects, the proposed change to 1031 exchanges in which gains will be charged over $500k, will most likely not hit smaller-scale investors that hard. But actual real estate investment volume will undoubtedly decrease and property prices may fall in the short-term. We have advised our clients that the increase in cap gains may lead to a strong seller's market, with a requisite slowdown of the real estate market, because holding periods would increase and subsequently less inventory will hit the market. Why sell a performing asset if you know you will owe a huge tax bill?

It is likely that offsetting taxes by investors will be done via increased use of installment sales and seller financing, reduced sponsor investment, increased rents, strategic maintenance deferral, and fewer capital projects. - Michael Nerenberg, Partner, Borah, Goldstein, Altschuler, Nahins, & Goidel, P.C., MNerenberg@borahgoldstein.com (mailto:MNerenberg@borahgoldstein.com)

Q: What are the effects of eliminating 1031 like kind exchanges coupled with capital gains tax rate increases?

Eliminating 1031 like kind exchanges would be a big disincentive to the sale of property, and in turn would hinder development. Coupled with capital gains tax rate increases, elimination of the 1031 exchange would further retard the trading of property. Also, it would put a up a roadblock for many who may want to sell property, because the tax consequence is too great. The need to make more properties sell to investors who are better able to develop will decrease the availability of developable properties. Existing properties may only resort to mortgage refinancing which will not create value added opportunities. - Joel Marcus, Esq. Partner, Marcus & Pollack, LLP, Real Estate Tax Certiorari, JMarcus@MarcusPollack.com (mailto:JMarcus@MarcusPollack.com)

Q: As specialists in real estate taxation, what is your take on President Biden's proposal to limit 1031 exchanges? Also, what effect will have by reducing the lifetime exclusion from $11.7 million to $3.5 million and/or eliminating the "step up" basis when a person inherits real estate at death.

Business and investors can swap real estate on a tax deferred basis for about 100 years. Biden wants to cap this tax deferral technique to $500,000 per taxpayer for transactions after December 31, 2021. Capping 1031 will impose a large income tax cost to US businesses and make them less competitive against our foreign counterparts. Further, businesses and investors will hold real estate for much longer to avoid the tax cost, creating inefficiencies in our economy and possible moving certain businesses offshore. The real estate industry is one of the backbones to the U.S. economy and real estate created a lot of wealth in the U.S. We feel that limiting 1031 will reduce real estate values and could put the U.S. economy into a serious recession. Therefore, we are recommending to our real estate owners to consider diversifying their non long-term real estate holdings by selling and acquiring real estate that can be long term holds before 1031 is repealed. Either way, any real estate owner will need to consider the effects of the repeal of 1031.

Many real estate owners and operators have net worth's over $3.5 million especially those living in the Tri-State area. Any additional federal estate tax imposed because of this reduced lifetime exemption will be very costly because real estate operators don't have the necessary cash to pay this higher estate tax at death hence increasing more stress sale of real estate. Also, if the "step-up" in basis is further moved, then the cost of transferring real estate at death will be very costly, therefore making tax planning more crucial for real estate families. - Kenneth Rick, CPA, Janover LLC, ken.rick@janoverllc.com (mailto:ken.rick@janoverllc.com) and Barry Sunshine, CPA/Senior Tax Partner, Janover LLC, barry.sunshine@janoverllc.com (mailto:barry.sunshine@janoverllc.com)